



Happy Holidays

We wish Good Health, Peace and Prosperity for you and yours in 2012.

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Within the franchise, distribution and dealership context, we are experts in:



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We offer a free initial consultation. If any readers have questions, you are welcome to email or phone us and we will provide our best answer as quickly as possible.

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Damages in Wrongful Termination Cases: A Comparison

Lost Profits or Lost Business Value

When a perceived wrongful termination situation arises, the franchisee may seek an injunction to prevent the termination or may bring suit for damages. There are several measures of damages which may be employed in these circumstances, some determined by statute and others by court decisions. And there is a very substantial issue as to how a terminated franchise is to be valued when it has been wrongfully terminated.

The two general claims made by wrongfully terminated franchisees are for lost profits and/or loss of business value. In theory, the value of a business is the present discounted value of its future lost profits so both concepts should yield the same result.

In *Baur Truck** a manufacturer licensed a second distributor in the plaintiff's territory and the "change in competitive circumstances" in the nature of encroachment was deemed a wrongful termination under Wisconsin law. In *Cooper v. Amana ("Cooper I")*** the manufacturer decided to sell directly to retailers in the distributor's territory and then refused to renew the distributorship. This was held to be a wrongful termination under New Jersey law.

In *Baur* the court found the proper period for measuring the damages was the two years of operation before the wrongful termination, while in *Cooper* the court found that the years before the termination could not be used to measure damages for lost profits.

In both cases the distributor's sales and profits were going up before the wrongful acts began and dropped precipitously afterwards. In *Baur* the plaintiff was allowed to base his future damage calculation on sales figures from before the manufacturer placed the competing distributor in Wisconsin.

In *Cooper I* the court reached a contrary result. On the second appeal (*Cooper II****), the Third Circuit held that Cooper's pre-termination loss of profits, caused by an attempted termination in 1991 was recoverable for the period from 1991 to 1994. But the court refused to allow a discounted cash flow analysis to calculate the loss of profits post-termination, i.e., after 1994.

In *Cooper I* the Third Circuit had stated that a franchise may be valued as either: "the present value of lost future earnings or the present market value of the lost business."

But on the second appeal in *Cooper II* they changed their mind. "[T]he Third Circuit backed off of its prior endorsement of alternate valuation measures and expressed a strong preference, if not an outright requirement, for the use of market value (i.e., value based on the hypothetical willing buyer/willing seller). The *Cooper II* court rejected the franchisee's arguments that the value could be based upon the present value of the lost future earnings expected if: (1) the franchise remained in the hands of the present franchisee; or (2) the franchise was taken over by the franchisor (as actually occurred). According to the *Cooper II* court, the expropriation of the

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franchise by the franchisor as part of national consolidation is a termination 'in good faith and for a *bona fide* reason' and thus requires use of the hypothetical willing buyer/willing seller formula."****

The result at the second damages trial was a finding that a willing buyer would not be willing to pay anything for a terminated franchise.

*(Wis. Ct. App. 1993) CCH Business Franchise Guide ¶ 10,193
**63 F.3d 262(3d Cir. 1995) CCH Business Franchise Guide ¶ 10,743
***180 F.3d 542 (3d Cir. 1999) CCH Business Franchise Guide ¶ 11,650
**** Brian J. Neff and Kenneth K. Lehn, "Damages Recoverable in Franchise Termination Cases," *New Jersey Lawyer* (Feb. 2000) at p. 42-43. The authors represented Cooper.

Is Arbitration Really Quicker and Cheaper?

According to a very recent posting by the eminent and super-qualified franchise lawyer, Pete Silverman of Shumaker, Loop & Kendrick, LLP, in Toledo:

AAA keeps statistics on a rolling 100 latest cases. Latest statistics I've seen reviewed 57 1-member panels and 43 3-member panels. Average time to award in 3-panel cases is 517 days for 3-arbitrator panel, 375 for 1-arbitrator panel. Average arbitrator fees for 3-member panel is \$111,576; average fees for 1-member panel is \$20,430.

Huge U.S. Business Lobby Hacked By Chinese

Months After "Clean-up" Strange Signs of Intrusion Persist

The United States Chamber of Commerce has confirmed Chinese hackers last year broke into internal networks. The Federal Bureau of Investigation was the first to alert the business lobbying group that servers in China were accessing the Chamber's internal network early in 2010. A subsequent internal investigation found the hackers had zeroed in on four of the lobbying group's Asia policy experts and that at least six week's worth of e-mails had been pilfered. The Chamber shut down the operation in May 2010.

According to *The Wall Street Journal*, which originally reported the story, despite these measures the Chamber continues to see suspicious activity. For example, a thermostat at a town house the Chamber of Commerce owns on Capitol Hill at one point was communicating with an Internet address in China, they say; and, in March, a printer used by Chamber executives spontaneously started printing pages with Chinese characters.

IRS Issues International "No Ruling" Areas

In Listing of Areas Where the IRS Will Not Provide Advance Advice Are Some Affecting International Franchising

As a general rule, in the interest of sound tax administration, the Service answers inquiries from individuals and organizations regarding their status for tax purposes and the tax effects of their acts or transactions before the filing of returns or reports that are required by the Internal Revenue Code. There are, however, areas where the Service will not issue letter rulings or determination letters, either because the issues are inherently factual or for other reasons. These areas are set forth in sections 3 and 4 of Revenue

Procedure 2012-7 which was released January 3, 2012.

Many of the areas addressed are highly technical but some that may impact franchise companies in the international arena, and the applicable provision of the Internal Revenue Code, are as follows:

- Section 7701(b).-Definition of Resident Alien and Nonresident Alien.-Whether an alien individual is a nonresident of the United States, including whether the individual has met the requirements of the substantial presence test or exceptions to the substantial presence test.
- Generally, the prospective application of the estate tax to the property or the estate of a living person
- Whether a proposed transaction would subject a taxpayer to criminal penalties.
- Section 894.-Income Affected by Treaty.-Whether a taxpayer has a permanent establishment in the United States for purposes of any United States income tax treaty and whether income is attributable to a permanent establishment in the United States.

And a no-ruling area that leaves taxpayers regularly perplexed - is a specific tax paid abroad eligible for the foreign tax credit:

- Section 903.-Credit for Taxes in Lieu of Income, Etc., Taxes.- Whether a foreign levy meets the requirements of a creditable tax under §903.

Awuah Continued: Are Franchisees Independent Contractors or Employees?

Subway, the Franchisor, Found Not an Employer of Franchisee's Employees

In an unusual situation, a Kentucky appellate court reversed decisions of an administrative law judge and the Kentucky Board of Workers' Claims and found that a franchisor of sandwich shops could be liable for the payment of workers' compensation benefits for an injured employee of a franchisee under the Kentucky Workers' Compensation Act because the nature of the relationship between the franchisor and franchisee could have constituted "remuneration" under the Act, and the franchisee could fit the Act's definition of a "subcontractor."

The lower decision went against every representation in the franchise agreement that the Zor and Zee were in an independent contractor relationship. When the case finally reached the Kentucky Supreme Court, however, the decision was overturned.*

*Doctors' Associates v. Uninsured Employers, Ky. Sup. Ct., CCH Business Franchise Guide ¶14,736

ESI: Best Practices for E-Discovery

The New York State Bar Association recently released "Best Practices In E-Discovery In New York State and Federal Courts" which was approved in September, 2011. The report lists 14 specific guidelines with extensive and informative commentaries. It also includes an excellent glossary of E-Discovery terms. The document may be found on the NYSBA website [here](#).

ESI: When the IRS May Summons Metadata

Wide Discretion To Seek Unaltered Electronic Records

IRS Chief Counsel has described when the agency may summons a taxpayer's unaltered metadata in an electronic file if the data is relevant to the examination. Many taxpayers, Chief Counsel noted, maintain their records electronically with metadata created as an integral part of the records.

Metadata is secondary information not apparent on the face of a document that describes its characteristics, origins, and usage, for example, its name, size, creation date, and date of last modification. (For more on metadata, see [The Franchise Valuation Reporter, April 2010.](#))

According to Chief Counsel, as long as the metadata may be relevant to the proper purpose for which the examination is being conducted, such as ascertaining the correctness of the return, the IRS may summons the metadata. If a taxpayer offers to supply copies that omit the metadata, the IRS may summons the original metadata. A taxpayer's offer to provide a truncated copy of the files without the metadata would likewise not impair the IRS's ability to summons the metadata.

Additionally, Chief Counsel noted that the IRS may summons metadata concerning transactions and events that occurred before and after the periods under examination so long as that information may be relevant to the examination.